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I. MASTER HYPOTHETICAL RESPONSES

1. Farm and construction equipment are very suitable trades for an industry located in the city of Rosario, Province of Santa Fe, Argentina or its surroundings. Rosario is a riverside city (the River Paraná) located in the middle of agricultural country and is the main grain-exporting port in Argentina. There are farm equipment industries and construction machinery industries in the region. There has been more than one example of farm machinery manufacturers in financial distress and now under actual reorganization procedures in the Rosario courts. The manufacturers' gross income and debt are similar to those of Heavy Duty Argentina II.

2. An enterprise that has been in business for forty-five years is not entirely rare in the area. There are some examples of industries that have been in governmental ownership and were later privatized (an aspect of particular importance nowadays in view of the privatization policies of the present administration). Some industries were in semi-governmental status (in the 1970's a procedure for the takeover of insolvent businesses by the State was implemented by Law No. 18.832, but that procedure was later suspended).

3. Probably, Heavy Duty Argentina was a limited liability company ("sociedad de responsabilidad limitada") at its inception (limited liability companies have been a possibility in Argentina since 1932) but has transformed itself into a corporation ("sociedad anónima"). Then again, it may have been a corporation since its inception forty-five years ago.

4. Argentine corporation law provides for a body of administrators composed of a "President" of the corporation (who is the legal representative of the corporation) and "Directors" (although the "Body of Directors" can be composed of only one person). An optional "Vice-President" of the corporation is the alternate President in case of

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impediment or absence. Directors are allowed to be assigned specific roles, in which case they would be called, for example: "Financial Director" or "Administrative Director." There could also be a "Syndic" (with a role somewhat like that of an auditor without power to supervise operations) but this office is optional, provided that: (i) the legal capital of the corporation is under 2.1 million Argentine pesos; (ii) it does not make public offer of its shares or debentures; (iii) it does not make appeals to the public for monies in exchange for promises of future services or benefits; or (iv) does not enjoy public concessions or services.

5. There are some remarks to be made to this respect, as contributions could have been made as loans under the format of "irrevocable contributions of capital," which has a specific treatment. I will examine that later.

6. Gross Sales

The gross sales of Heavy Duty Argentina II in the Master Hypothetical are in accordance with the local economy. In fact, it is quite similar to a local manufacturer of farm machinery, located in the outskirts of Rosario. This local manufacturer's yearly gross sales for 1995 were $26,000,000, when it had a loss of $6,000,000, and its profits for 1994 were $1,600,000, with gross sales of $55,000,000. Its total work force is 305 employees.

7. Number of Employees

Heavy Duty Argentina should have 300 employees. That would fit the gross income of $20,000,000, as salaries in the Rosario area are around $400-500 monthly average ($1,000-1,200 plus labour taxes). Besides, there are no 5,000 work-force employers in Santa Fe Province (the largest having 2,190 and only two are over 2,000, number 3 is already down to 1,077). General Motors Argentina has announced that the plant now under construction in Santa Fe will employ 1,370 workers.

8. Pension Plans

Law No. 24.241 has reformed substantially the system of pensions in Argentina. Previously, most employers, employees, workers and self-employed individuals had to contribute to a State-run pension system that in turn paid the pensioners. Now the law determines a system of Pension-Fund Administrators ("Administradoras de Fondos de Jubilaciones y Pensiones" or "AFJP") that have to be organized as corporations (Sociedades Anónimas), from whom the worker freely requests its services. The contributions are paid in by employers, employees, workers and self-employed people towards a fund that is the property of the worker. The

AFJPs have a right to a commission. In case of non-payment, the National Tax-Collecting Agency (the "DGI"), which is also in charge of collecting pension plan contributions, promotes proceedings against the defaulting debtors. But in no case is there a relation between the pensioners and the ex-employer. Once the labor contract is terminated, there is no further relation between ex-employer and ex-employee. The employee may or may not be in a condition to request pension benefits from the Unified System of Pensions, but he shall not be a creditor to the ex-employer for pension contributions.

9. Split ownership of land (public/private) is not a possibility under Argentine law. Land could have been public at one time and gone private ("privatization") or it could have been private and gone public (expropriation procedures should have been promoted). There are some mixed private-public business forms: corporations formed by the State ("Sociedades del Estado," Decreto 15.349/1946); corporations with its majority capital owned by the State ("Sociedades de Capital Estatal Mayoritario"); and mixed economy corporations ("Sociedades de Economía Mixta," Ley 12.962). As none of these are under the contract requirements (e.g., bids) that are mandatory for State agencies, these formats were in use when the State was active in business. The privatization trend has put a hold on their use.

10. Lease Terms

A ninety-nine year lease is invalid under Argentine law. The maximum term is ten years, a longer-period lease would be restricted to ten years. A lease of nine years is therefore, fully valid. It could be a possibility that Heavy Duty Argentine rented for a long period of time a factory-site that belonged to the State. That would not be a common situation but by no means would it be unlawful. Some other similar situations, involving "real" rights on property, such as uses ("usos," "habitación," and "servidumbres") are restricted to twenty years.

Law No. 24.441 introduced a new device in Argentine law that may prove useful in our case. It is the case of the contract of "Land Leasing." "Leasing" takes place whenever a contract of lease is stipulated together with an option to purchase and the following provisions are present: (i) the lessor is a financial institution or a company dedicated to leasing; (ii) the land has been purchased by the lessor with the specific purpose of leasing it to the lessee; (iii) the price of the lease is fixed in accordance with the value of the leased land. The maximum term of the contract of lease mentioned in the above paragraph is not applicable here; and (iv) the lessee has stipulated the election to purchase the leased land for a price fixed in

the agreement that has relation with the land's presumed residual value. The election shall be made after the lessee has made payment of half of the periods of rent stipulated in the agreement or before, if so stipulated. The agreement instrument shall be filed in the Land Registry.

11. Costs

Costs vary substantially from trade to trade. The ones proposed below have been taken from a similar size industry, although of a trade different from that of Heavy Duty:

(1) taxes: (i) VAT 8.5 % (it is 21% but it comes down to 8.5% after set-offs); (ii) Provincial Gross-sales Tax: 1.5%; (iii) Municipal tax: 0.65%;

(2) salaries: 20%;

(3) pension and health plans: 10%;

(4) insurance: 2% (12% of salaries). This could be higher according to trade: in some industries there have been high costs assigned to job-related injuries such as hearing-impairment ("hipoacusia") which became very popular sources of litigation;

(5) freight, electricity, natural gas, water, maintenance, fees: 9.5%;

(6) raw materials: 42%; and

(7) profits: 3.85%.

12. Shortages

One important cause of shortages in local industries is in fact the currency market: the difficulty in coordinating sales with the supply of materials and parts. Heavy Duty Argentina sells bulldozers. To make bulldozers it needs engines, axles, transmissions, gearboxes. Heavy Duty Argentina produces none of these items. Let us assume that it buys Mercedes-Benz engines and ZF gearboxes. None of them are produced in Argentina and Heavy Duty will have to import them from Brazil or Germany. In both cases, Heavy Duty will have to open a letter of credit for the imports with a local bank, as the manufacturers will not give direct credit to Heavy Duty. Interest rates being too high to make the operation profitable, the letter of credit will have to be paid in cash to the local bank. That means that Heavy Duty must have the cash ready for the operation. But Heavy Duty's buyer for the bulldozer, in turn, has no access to loans which could possibly be paid with the profits from its own operation, so it will not buy unless Heavy Duty gives credit on its own. Unless Heavy Duty puts up the cash to close the deal, it will have no access to imports that are vital for its operation. By the general stay on creditors prescribed for in reorganization proceedings ("concurso preventivo") under Law No. 24.522, an affected industry should be able to gather the cash necessary to

maintain itself in operation. Privatization of utilities in Argentina has also put a grip on industry: electricity which was before privatization State-provided at lower costs, now is much more expensive.

13. Interests and State Assistance

(a) Heavy Duty II would have to pay high interest rates to obtain credit. Loans from banks have a very high cost for a company its size. Market interest rates would be around 20-25% yearly (on U.S. dollar loans). Heavy Duty Argentina II has earnings of $1 million a year so it should have no problems with paying high interest rates, but most companies in Argentina are not that profitable.

A farm-equipment factory similar to Heavy Duty II established in the Rosario area recently proposed a plan to its creditors. The plan was an extension of eight years, ending in 2004. Payments should start in the second year and involve 5% in the first and second year, 10% in the third year, 15% in the fourth and fifth year, 25% on the sixth year, and 25% on the seventh year. Interest offered was LIBOR plus 3% for debts in Argentine pesos and 1.5% for debts in U.S. dollars. All governmental creditors (tax agencies from the nation, province and city) and State-owned banks voted in favor of the proposal, which was confirmed by the judge.

The matter of high interest rates is under heavy discussion now and has become news in the local newspapers. Titles such as "The Average Profitability rate of the economy is below that of the active rate of interests. Banking debts are in default" (Hugo Tarrio, "La Capital," April 14, 1996, at 6). are recurrent. There have been many indications of governmental preoccupation: "Interest rates must go down" ("La Capital," March 27, 1996, at 2). Enterprises are not in a condition to obtain finance from bank loans: "Rates for Medium-and-Small Enterprises are of lead" ("La Capital," March 24, 1996, at 3); "There shall be Loans at 9.5% for Medium-and-Small Enterprises" ("Ambito Financiero," March 15, 1996, at 4). Banks request measures that would make credit attractive to the public ("Ambito Financiero," March 21, 1996). At the same time there is a strong decrease in loans: the Ministry of Economy has put pressure on the banks to lower their rates of interest ("Ambito Financiero," February 28, 1996). The results are not yet obvious.

A proposed act is presently under consideration by the Santa Fe Provincial House of Representatives (an initiative from the Ministry of Production of Santa Fe) proposing to create a fund that would subsidize rates of interest. The Province would pay from that fund some ten points of the rate of interest. The act has not been passed into law and it is the main initiative in that field that the present administration of the Province of Santa Fe is envisaging.

Recurrent motions for revision of interest paid has been made before the Rosario Courts of Justice. Some recent orders to that effect have established that the maximum rates admissible in Argentina are passive banking rates for non-bank creditors and active banking rates for bank creditors. In some cases, the impact of these orders have been that the debtor's responsibilities have been reduced by half.

(b) There are extensions for default in payment of taxes:

(i) The National State agency for the collection of taxes and pension-fund contributions (DGI) shall grant an extension of sixty months for tax and labour tax debts with priority status, plus interest of 1% monthly to enterprises under judicial reorganization proceedings (Resol. Grl. n°3.762 and n°4.037).

(ii) The Province of Santa Fe Tax Agency (API) shall grant an extension for six months, provided there is a down payment of 20% and satisfactory collateral is provided (Resol. API; in cases where an insolvency proceedings has been opened, the extension can be up to thirty-six months (Resol. API);

(c) With the exception of extensions for taxes and labour contributions, there is no assistance program for enterprises in financial difficulties in the Province of Santa Fe. There is some special assistance to "Medium and Small Enterprises" (PYMES). An industrial PYME (according to the manual, "Instruments of Financing and Counseling PYMES" published by the Ministry of Economy) is an enterprise that sells less than Ar$18,000,000 per year and employs less than 300 workers. Heavy Duty Argentina II is quite near those standards. According to the information received, the entire funds that the National State has to give financial assistance to PYMES is Ar$500,000,000, so very few of them have access to these loans. The maximum amount possible for a single enterprise under those subsidized plans is $ 500,000.

14. Pollution Claims

As stated above, Rosario is a riverside city, so pollution downstream is not entirely a rarity here. Heavy Duty II would not be a very dangerous polluter, according to the information requested, owing to its trade (oils used in machinery processes and human wastes would be the major effluents). But there are quite a few slaughter houses and chemical plants in the Rosario area. Some research in the Provincial agency in control of Environmental matters (Dirección de Saneamiento Ambiental) has revealed only two cases in the area, both having been settled out-of-court. One involved strawberry patches that used the river for watering. The other involved a claim made by the authorities of a small town complaining of pig-farm effluents. So the case described in the hypothetical is possible.

Santa Fe Provincial Law No. 10.000 ("Intereses Difusos") has paved the way for class actions against the State in this area.

15. Insurance Costs

By Law No. 24.557 and Executive Decree No. 334/96 a new system for labor-risk compensation has been introduced, creating special associations for labour risks ("Asociaciones de Riesgos del Trabajo" or "ARTs") have been devised and are operative as of April 1st, 1996.

The average cost of labour accidents and workers compensation insurance in Argentina was (before the new law) over 12% of salaries, and that made the employers complain about excessive compensations and the impossibility to estimate costs. The cost of labour insurance is expected after the new law to be reduced to around 3-4% of the payroll (statements made by the National Minister of Labour in "La Capital," April 2, 1996).

The new law tends also to curb excessive labour claims ("Ambito Financiero," April 4, 1996).

16. Bankruptcies and Reorganizations

In 1995, there were 1627 bankruptcy petitions in Rosario, Santa Fe. The aggregate of 1994 and 1995 shows 4468 petitions. Since March, 1996, there has already been 360 petitions for bankruptcy.

There were 1640 reorganization proceedings ("concursos preventivos") in Rosario, Santa Fe in 1995. The aggregate of 1994 and 1995 shows 4417 petitions. Up to March, 1996 there had been 353 petitions for reorganization.

II. CORPORATE QUESTIONS

Some basic aspects should be stated beforehand:

The Contract of Society

As in all other systems of law derived from the French Civil Code, all business partnerships and corporations are originated in contract, the "contract of society". This puts the law of partnerships and corporation under somewhat modified rules derived from the law of contract. All valid contracts of society are reputed in Argentine law to produce a separate entity ("societary personality") with separate assets distinct from those of the parties to that contract (although there is some discussion with regards to the "accidental society," a form of joint venture). Separate entities may not be recognized by Tax Law, which is different than Private Law constructions.

Typification (Art. 17 LS)

The diverse contracts of society have to mandatorily fulfill some "essential" prerequisites ("typification") established for each business structure by the relevant statute ("Ley de Sociedades"). Failure to meet these "essential" prerequisites in the founding instrument shall result in nullity of the contract. An example of this would be the bylaws of a corporation ("sociedad anónima") providing for joint and several liability of the shareholders, as limited liability of the shareholders is an "essential" prerequisite for a corporation. A court order declaring nullity of the society shall also order the liquidation of that society.

Regularity

All contracts of society shall be in written form and their instrument shall be filed ("registered") with the Public Registry of Commerce of the jurisdiction where it intends to have its domicile. Lack of a written instrument ("de facto society") or lack of registration ("irregular society") shall derive in its instant inclusion in a common category: "not regularly organized," provided it does indeed meet "typification" standards (lack of typification standards shall result in nullity and not irregularity). Irregular and de facto partners are jointly and severally liable for the debts of the irregular society (not being allowed to require prior execution of the society's assets). Any and each of the partners shall engage the society's liability. An irregular or de facto society shall be considered to have a distinct body of assets, with the exception of assets that statutorily require registration (such as land or automobiles) to acquire property.

Irregularity also signifies that any of the partners or members shall be entitled to demand dissolution of the society's (and ensuing liquidation of its assets) at any time, and that society shall be reputed to be dissolved as of the time when the notice of this demand has been served to the partners. An irregular or de facto partnership can be "regularized" by a decision of the majority in number of the partners (even after the court filing of a dissolution petition) to write out the new instrument and/or register the existent one with the Public Registry of Commerce.

There is discussion vis-à-vis specific circumstances, when an "essential typifying trait," or when "ordre publique" are involved. This makes draftsmen of articles of incorporation and bylaws of corporations and other "society contracts" to be particularly wary of innovations or of using wording much different to those employed by the statute, or to use options that the statute does not specifically allow. The existence of model articles of incorporation and bylaws authorized by the agency in control of corporations ("Inspección de Personas Jurídicas") is another stepping block for the imagination of draftsmen.

All options indicated in the Master Hypothetical accompanying questions are open for Heavy Duty Argentina II

A. Options for Organization

The statute provides for four types of partnerships, and some other legal structures:

1. General Partnership ("sociedad colectiva")

All partners are severally liable for debts of the partnership, but only after unsuccessful execution of the partnership's assets. In default of a specific provision in the partnership agreement, all partners shall be deemed full administrators. Only one general partnership was filed with the Rosario Commerce Registry in 1995, ten in 1994 and two in 1993;

2. Limited Partnership ("sociedad en comandita simple")

There are here both "general partners," and "limited partners," the latter being only liable up to the amount of their contributions to the partnership (limited liability), which shall not consist in any obligations to perform services. The administration must be held by the general partner (or a third party) and the limited partner is forbidden to do so, under penalty of being held as a general partner for all obligations of the partnership. The limited partner is also forbidden to act as an agent. No limited partnership is filed with the Rosario Commerce Registry;

3. Capital and Industry Partnership ("sociedad de capital e industria")

There are both a "general" and a "limited" partner. The contribution of the "industrial" partner shall consist solely in his personal services. The "industrial" partner shall be liable only up to undistributed profits. No capital and industry partnership is filed with the Rosario Commerce Registry. It has been considered apt to instrument a fraud to a labour contract; and

4. Limited Partnership by Shares ("sociedad en comandita por acciones")

It is basically a limited partnership with both general partners who solely may execute the administration—and limited partners who are prohibited to do so, but the contributions to the capital by the limited partners are represented by shares and because of that, they are considered to be shareholders. Some wording concerning the meetings of partners and shareholders, and transfer of general-partner interests and the ways of taking resolutions are provided for in the relevant statute. A third party may be an administrator. There were some inheritance-tax reasons for their popularity some twenty years ago, but inheritance-tax having been

abolished in Argentina, they no longer offer benefits to a corporation. There are a few limited partnership by shares in existence in the region, but their number is decreasing. None was registered in the period 1993-1995 and five requested their transformation into corporations in 1995.

5. Cooperatives and Mutualities

These are not "business" structures, and mutualities are only authorized to pursue their purpose among their own members. Santa Fe Province, and the surrounding provinces, historically have had a very strong cooperative and mutualities system. Banking and insurance are fields where cooperatives and mutualities are deeply involved (although their participation in the business is constantly shrinking). Given the context of the Master Hypothetical (a family-owned business enterprise), these structures do not seem appropriate, so I will concentrate on the two most popular limited-liability structures in force in Argentine law: the "Sociedad de Responsabilidad Limitada," and the "Sociedad Anónima."

B. The Selection: Limited Liability Company or Corporation

The selection of a legal structure for Heavy Duty Argentina II will have to be made between a limited liability company (SRL) or a corporation (SA). These are the only business oriented structures that provide limited liability to the owners of the equity of a company, as well as certainties on the personal liability of directors. They are also the most frequently used formats, with abundant statute and case law. But perhaps the criteria for selecting an appropriate legal structure shall not be entirely based in the law. The SA (even a close corporation) lends more prestige to the business, as large enterprises have traditionally adopted the SA format. That format is obviously more apt to conduct large business as the participation of shareholders in the most important corporate decisions is assured and, as such, the possibility of the owners of the contributions of capital to protect their interests. But in the case of the close corporation, such differences grow dimmer. Nonetheless, banks tend to require directors to provide their personal collateral as security for loans made to the corporation (and not to shareholders). In contrast, they tend to require personal collateral security of all members of the SRL. This may prove important in case of insolvency. Tax differences between them are minimal, to the extent that they do not offer shares or debt securities to the open market. An SA is deemed to be a "society of capitals," while the SRL is supposed to be a "mixed society of persons and capital." This proves to be a rather thin discussion, but it appears valid when examining an equity transfer restriction worded into a "society contract." Transfer

restrictions are apt to be more acceptable in an SRL than in an SA. The decision whether to incorporate Heavy Duty Argentina II or to vest a limited company upon it will rest primarily with the lawyers and accountants. In some cases, the notary public shall also provide his experience and know-how. The owners of the equity shall of course be parties to the decision.

1. Limited Liability Companies ("sociedad de responsabilidad limitada" or "SRL")

This is the most popular business structure in the Rosario region. There were 890 SRLs registered in Rosario in 1995, 1000 in 1994 and 900 in 1993. Its most important feature is that they limit liability of the members to the capital subscribed. Number of members cannot exceed fifty. Administration is held by one or more "Managers" (who may be outsiders) registered in the Commerce Registry. The office of Managers can be held (i) severally, each one of the Managers engaging liability for the SRL, (ii) jointly, requiring the joint decision of the plural managers; or (iii) collegiate. This variety is a very popular feature of the SRL. There are some minimum initial capitalization requirements introduced by the Judge in charge of the Rosario Registry of Commerce (from $ 2000 up to $ 5000 according to the trade intended). The SRL is envisioned as being more an "society of persons" than a "capital society" (such as a corporation), and this results, among other things, in a less strict view by the courts on transfer restrictions based on personal issues.

2. Corporations ("sociedades anónimas" or "SA")

This is the second most popular business structure in the Rosario region, but undoubtedly the most popular for medium and large enterprises. There were 170 SAs registered in 1995, 196 in 1994, and 185 in 1993. The SA is envisaged as the structure for large business. This is not entirely true, as the SA is a very flexible instrument, offering a structure both to the large enterprise and to the smaller businesses. Nonetheless, operations that require large contributions of capital are reserved by law to the SA. Banks, insurance companies, pension-fund administrators and other fields of big business are limited to the SA (together with the cooperatives and mutualities, whose importance is shrinking nowadays). SRLs cannot make public offers of interests neither can they issue negotiable debt securities under Law No. 23.576 ("obligaciones negociables"). Only SAs can make public offer of their shares and certificates of debt.

C. Distinctions Between an SA and a SRL

1. Organization

An SA has a more formal organization, both at inception and during its operation. In the Province of Santa Fe, an SA has to obtain previous State approval before organization, a bureaucratic procedure that has been disposed of in other Provinces. Thus an SA in Santa Fe is under two controls: that of the specific agency (Inspección General de Personas Jurídicas) and that of the Judge in charge of the Commerce Registry. An SRL does not need this State approval. An SA requires its act of incorporation to be written into a notarized instrument, while an SRL contract can be worded into a private instrument. Both of course must be filed with the Commerce Registry.

2. Capital

The capital of the SA shall be represented by shares (this is an essential typification prerequisite). SRLs are not allowed to represent their capital in such negotiable securities under penalty of nullity of the SRL. Transfer of SA shares may be subject to restrictions but cannot be entirely prohibited by the articles of incorporation and bylaws. An SRL, being a "society of persons," allows for more restrictions in the assignment of interests to third parties.

SAs have by Federal statute a minimum capitalization prerequisite of $12,000, while SRLs are under the smaller capitalization prerequisites imposed by the local Judge. If capital exceeds $ 2,100,000, the SA is subjected to a permanent control by a special agency (powers of this agency are to suspend corporate resolutions, request judicial intervention and even request dissolution).

3. Administration

The SA is under the administration of a Board of Directors ("Directorio"). The President of the SA is its legal representative. The Board is normally a plural collegiate body and the Board of Directors' resolutions are to be taken by a majority of votes. Meetings of the Board require the physical presence of the directors (or their proxies), as voting by mail or telephone is not allowed. The statute allows a one-director Board, who shall also be the President of the SA. Conformity of the administration to the law shall be under the supervision of the office of an auditor under the name of "Syndic" (or a collegiate board of Syndics) or a special board of supervision: the "Consejo de Vigilancia" (which has some administrative powers). The office of Syndic can be disposed of by the articles of incorporation or by their later amendment, unless capital is

over $ 2,100,000, or the SA makes a public offering of its shares, or enjoys certain public benefits or performs public services.

4. Operation

The governing body of the SA is the General Meeting of Shareholders, which is subject to strict formalities (anticipatory notices are to be published, quorum and majority requisites are imposed, the meeting has to formally take place with the actual presence of the shareholders or their proxies). In the SRL, the formalities are less strict and resolutions can be taken by simple consultations made by the Manager to the members.

5. Majority – a Prerequisite in Both SA's and SRL's

In the case of the SA, it refers to the majority present at the voting time at the meeting except in some very important decisions, where majority is determined in reference to shareholding. In the SRL, it refers to majority in capital. In the SA, there is the possibility of cumulative voting for officers in the board of directors and syndics (the shareholder can accumulate his votes for a single candidate up to a third of the offices open for election).

6. Personal Liability of Directors

Personal liability of directors of SAs is discussed below in somewhat more detail, but in principle, the collegiate body of corporate directors is liable only for misadministration; violation of the articles of incorporation, the bylaws, and of the statute; and for gross negligence and prejudicial conduct with knowledge thereof. Division of functions among the directors of the corporation may entail separate liability, but this is somewhat dimmed by the fact that the Directors must act as a collegiate body, and as such, all Directors will be liable for collegiate resolutions of the body. In the SRL, by contrast, division of functions among the managers (when the managerial function is not collegiately organized) is more clearly divided. Whenever functions are assigned in an SRL, each director and specific manager involved shall engage the SRL, and the others shall not engage liability.

7. Personal Liability of Shareholders

Personal liability of shareholders of the SA is strictly limited to each shareholder's own subscription of capital. In the SRL all members are guarantors and liable for the entire payment of subscribed capital and for the over-valuation of contributions in-kind to capital, both at inception and upon further increases, although this liability is operative only in bankruptcy. In both the SA and the SRL, members and shareholders are

held personally liable for the prejudice derived from resolutions that have been declared null.

8. Dividends

Payment of legally available cash funds due to earnings after the yearly financial statements are approved by the General Meeting of Shareholders, and a special resolution is passed by the General Meeting to distribute them. Dividends may also be paid in shares or in kind. In the SA, a distribution of provisional dividends (before approval of the General Meeting) is allowed. That practice is not allowed in the SRL. The importance of this difference is evident in the context of payments of salaries made to directors, as well as in cash extractions made from the funds of the corporation by the shareholders.

9. Exclusion

This deals with a corporation owning a medical clinic where shareholders are also (and only) doctors who are bound to perform their professional services to the benefit of the corporation. In case of nonperformance, can the reluctant doctor be expelled? It is not clear whether a shareholder can be excluded (expelled) from the SA, but it is acceptable that he may be excluded from the SRL.

10. Tax Reasons and Pension Plan Contributions

Until very recently, the major difference between the SA and a SRL rested in its tax situation. Tax treatment was different in the SA and the SRL until September 25, 1996, when a new law was passed by Congress making them both taxpayers with an equal rate: 33% of earnings. While the SA was fully recognized by the taxman as an income-tax taxpayer before the new law, the SRL was not. There has been some zigzagging in the recognition of the SRL as an income-tax taxpayer. Hence the owners of equity in the SRL were considered income-taxpayers. Because of that, dividends of the SA were taxed as income (30% of earnings), while the owners of equity of the SRL paid income tax according to their individual holdings. Both the SA and the SRL are taxpayers for other taxes, e.g., VAT or sales tax. There is no difference in the situation of pension-plan contributions for its directors and managers between the SA and the SRL.

D. Organization/Participation

Organization and restructuring would be handled by the family, with the counseling of lawyers and accountants. Accountants would mainly

participate in restructuring. Compensation would be agreed upon between the lawyer and the client, as there are no compulsory, pre-established fees in this respect. There are no mandatory fees for the accountants either. All compulsory rates of fees were repealed in 1994 and 1995 (National law No. 24.432/1995). There is little experience in the field in Rosario, as there few examples of professionally-assisted restructures. Perhaps an approximation would be that the lawyer would charge a flat fee for the organizing of the new corporation (the fee should be some $3000), and perhaps an hourly-fee for further services (some $200 per hour). The accountants would probably aspire to charge a fee based on a percentage on sales.

E. Capital Structure

1. Capital Requirements in the Corporation (SA)

The existence of legal capital is a prerequisite for the corporation. If the articles of incorporation do not indicate corporate capital, it may result in nullity of the contract of society. Its main function is internal: it shall indicate how the majorities will vote (quorum requisites and voting power) and how dividends will be apportioned. Increasing or reducing capital implies amendment of the articles of incorporation and entails the most stringent quorum and majority requirements (an exception is taken for corporations that offering their shares publicly). Up to a future five-fold increase in capital may be approved before the actual increase is made. The function of capital as a protection to creditors has diminished. Assets are the real protection of creditors and legal capital is only a pallid indication of this; the balance sheet should be an accurate reflection.

(a) The law requires what legal writers call "verity of capital," whereby: (i) all contributions to capital shall consist of assets that can be legally sold in a judicial proceeding; (ii) all reductions of capital require previous notice and consent of creditors (dissenting creditors shall be paid or secured); and (iii) the amount of capital may be stated in the balance sheet in accordance with indexation calculations, although this is not consistent with the present prohibition of use indexing procedures ("Ley de Convertibilidad").

The "Comisión Nacional de Valores" (the Argentine SEC) does not allow this procedure. In one case, adequate capitalization to pursue the corporation's purpose was required. In another case, the Judge in charge of the Commercial Registry required a corporation sufficient initial capitalization for the pursuit of its intended purposes. These have been

isolated instances, but Law No. 22.182 (7.3.80) announced a minimum initial capital for the SAs: $ 12,000 (Executive decree 1937) as of 6.10.91 (b) The law also requires what legal writers call "intangibility of capital," whereby:

> (i) all shares shall be suscribed; (ii) valuation of contributions-in-kind shall require approval of the State agency of control; (iii) the corporation shall not be allowed to acquire its own shares; (iv) distribution of dividends shall be made only after cash earnings are declared in an approved financial statement; (vi) subscription of under par shares is not allowed; and (vii) new share certificates shall only be issued when all previous subcriptions have been suscribed (art. 190 LS).

The "Comisión Nacional de Valores" (Federal Agency in Control of Securities and Exchanges) has issued Resolution No. 58, whereby SAs who make public offerings of their shares need not amend their articles of incorporation and bylaws to reflect rises in capital, and need only reflect increases in their financial statements. This procedure has been authorized by Federal Law No. 22.686, art. 188, par. 1 without limits to raising capital.

2. Subscription and Payment of Contributions

Capital contributions shall be suscribed totally (art. 186 LS). This rule applies both for initial incorporation and further increases in capital (whereby all founding shareholders are to be indicated in the articles of incorporation). Each of the shareholder's cash contributions shall equal no less than 25% of the total subscription individually made.

Contributions in-kind shall be paid in fully upon incorporation. Contributions in-kind shall not consist of services, and they shall only be contributed in property. Services are allowed only as subsidiary contributions ("prestaciones accesorias") which are not considered capital, even if they give rise to a right to participate in earnings.

Cash capital contributions have to be paid in when stipulated within two years. If unstipulated, payment shall be made at the time of filing of incorporation. Increases in capital have to be paid in at subscription. An order for bankruptcy statutorily requires that all pending capital subscriptions be paid-in immediately.

3. Increases in Capital

Increases in capital require a General Meeting of Creditors resolution, which shall be: (i) ordinary, whenever the articles of incorporation allow for up to a five-fold increase in capital; or (ii) extraordinary, in all other

cases. Corporations that make a public offering of their shares take their resolution in ordinary meetings.

4. Formalities for Increasing Capital Differ

If the increase does not originate in fresh funds and only reflects the value of net assets ("revaluación de activos") or the capitalization of reserves or earnings, then the new shares shall be issued in proportion to each shareholder's holding, and immediately after the resolution is made.

If the increase in capital originates from an actual infusion of funds, then notice must be published in order for the existent shareholders to make use of their preemption rights to buy the new stock, before shares may be sold to third parties. Share certificates may only be issued after these procedures have been concluded. There is some opinion that fulfillment of these procedures has to be shown on filing the amendments in the Registry of Commerce.

The increase in capital shall be filed with the Public Registry of Commerce in order that it may take effect vis-a-vis third parties, but it takes effect immediately with regard to shareholders and officers (e.g., quorum and voting majority requirements). There is some opinion that filing of the increase is a prerequisite even for opposability between the shareholders and the corporation.

An increase in capital gives rise to the right to recess (the shareholder is statutorily entitled to promptly be paid his share of net assets in the corporation and leave, as a consequence of his dissent). This is in exception to cases where corporations make public offerings of their shares, capitalize their reserves, and revaluate net assets.

As stated, shares shall not be issued under par (art. 202 LS), except where corporations make public offerings of their shares in the Exchange and cover the difference with reserves (ley 19.060, ref. ley 20.643, art.1).

5. Increases in Capital Can Be the Result of:

(a) New equity.

(i) Art. 188 LS authorizes increasing capital of the SA up to five-fold whenever the articles of incorporation provide for such increases. In this case, the Ordinary Meeting of Shareholders shall pass a resolution to increase capital (art. 234, inc. 4 LS). The resolution must be filed with the Registry of Commerce;

(ii) Irrevocable contributions to capital ("aportes irrevocables de capital"). Irrevocable contributions to capital are commonplace. Given the formalities prescribed for increasing legal capital and the need to be able to use such funds, corporations obtain a loan for use as equity of the corporation, but the increase in capital is not

considered or resolved at the General Meeting of Shareholders. Accountants register them as capital, but legal opinion establishes that they are loans that give rise to an obligation on behalf of the board to promptly summon a Shareholders Meeting to consider the proposed increase. Said meeting enables the existent shareholders to make use of their options to buy the new shares. If they do, or if they do not pass a resolution to increase legal capital, then the corporation shall be under an obligation to return the moneys paid in to the lender. There is a time limit to passing such a resolution.

(b) Capitalization of reserves. The distribution of the share certificates shall be made in proportion of the existent shareholding. Some provisions are made by the statute in order to protect a dissenting minority. Reserves can only be made: (i) whenever reasonable and adjudged by a standard of prudent administration; (ii) if no losses are being carried from previous years; and (iii) when their need is explained in the directors' report.

(c) Capitalization of earnings. This is a variant of the previous case. Dividends need not be declared. If this is the case, then the shareholder is a creditor and cannot be bound by the new resolution to capitalize.

(d) Revaluation of assets.

(e) Capitalization of creditors (art. 43, Bankruptcy Law No. 24.522). This is one of the cases where preemptive rights are waived (art. 197 L S) inasmuch as new shares are issued as payment of existing obligations. The right to recede is also waived.

(f) Conversion of debentures (art. 334 LS) or negotiable certificates of debt ("obligaciones negociables") into shares. Conversion into shares, whenever stipulated, is an option for the creditor, whereby the increase in capital can only be made after the debenture holder elects to convert. In order that preemptive rights of existent shareholders are respected, the new shares shall first be offered to them. Debentures may be issued "under par" (nominal value is over its price) in contrast to shares (where issuance under par is not possible), in which case the difference shall be paid up at the time of conversion. The same is true of bonds (Law No. 23.576/23.962, arts. 11 & 12). In extraordinary circumstances related to the interests of the company, the General Meeting of Shareholders can waive the preemptive rights of shareholders, or limit the term for exercising their election to fifteen days.

Shareholders dissenting against the issuance of bonds can exercise their right to recede with the exception of:

(1) corporations that make public offerings of their shares;

(2) situations in which the General Meeting of Shareholders (Extraordinary) has passed a resolution waiving the rights of preemption; or

(3) situations whereby the corporation has entered into an agreement for underwriting with a broker for further sale to the general public.

Default on payment of shares subscribed. Default by the shareholder occurs through the mere failure to fulfill the obligation to pay for shares subscribed within the term established. Default on payment for shares shall immediately suspend all voting and patrimonial rights inherent to the shareholder. In the case of default, the corporation is in a condition to immediately promote court proceedings in order to obtain a compulsory payment, as well as damages and interests.

The articles of incorporation and bylaws can also provide for:

(1) public auction of the shares, or auction through a broker in case of public offering;

(2) a determination of whether the subscription rights are cancelled with loss of monies already payed in, after notice has been served for a term not under thirty days. If this be the case, the corporation shall cancel the shares.

7. Preemptive Rights of Shareholders

This right is conferred by the law on all existent shareholders, and it shall be allotted in proportion to existing relative shareholding, with respect to classes of shares (art. 250 LS).

If an existing shareholder has opposed the increase in capital at (or was absent from) the pertinent Meeting of Shareholders and is not willing to exert his preemption right, he may withdraw from the corporation (art. 245 LS).

All ordinary shareholders have statutory preemptive rights. Cash preference shareholders may only exercise such rights when they have been stipulated in the articles of incorporation or in the conditions of the issuance of preferred shares.

Preemptive rights shall only be denied under the extreme conditions of art. 197 LS (particular cases where the interests of the corporation make it mandatory), under penalty of nullity (art. 194, final par. LS).

Shareholders that have elected to exercise their preemptive rights shall also have rights of accretion whenever another shareholder declines to subscribe the new shares offerings (art. 194, par. 1 LS). Rights of accretion shall be exercised in proportion to the amount of shares issued at that particular time and to the number of shares of the shareholder exercising his preemption rights. Rights of accretion are also statutorily protected, and cannot be denied, with the stringent exception of art. 197 LS.

In order for preemptive rights to be exercised, the Board of Directors shall publish notice for three days inviting shareholders to elect to buy

whenever the General Meeting resolves to increase capital. The shareholders shall have notice of their rights of election within thirty days after the last notice has appeared.

In the case of corporations that make public offering of their shares, the Federal agency in charge of securities and exchange (Comisión Nacional de Valores) may alter the terms and conditions of the exercise of rights of preemption and accretion by reducing the shareholder notice requirement to five days (decreto PEN 2284/91 de Desregulación Económica, art. 84).

The shareholder that has been denied his rights of preemption shall have the right to have the new shares that would have been allotted to him cancelled. Whenever that is not possible, as when the new share certificates have already been delivered to third parties, he shall have an action for damages against the corporation and the directors, jointly and severally. The award for damages shall not be inferior to three-fold of the nominal value of the shares he was entitled to. This action has a statute of limitations period of 6 months after expiration of the term established for subscription. Directors and the Syndic(s) are also entitled to initiate proceedings, whenever they have not participated in the decision under question. When creditors are paid with shares in a reorganization insolvency proceeding, the right of preemption is denied.

8. Increasing Capital by Public Offering of Shares

Increasing capital by a public offering of shares shall be performed in accordance with Law No. 17.811, and in all cases, shall require authorization by the federal agency in charge of securities and exchange (Comisión Nacional de Valores).

Non-compliance with rules applicable to the public offering of shares shall render directors and syndics jointly and personally liable for damages arising from violation of said rules. The buyer is entitled to request annulment (art. 199 LS states it is null and void) of the subscription and to obtain damages from the corporation, board members, and syndics. In addition, the Federal agency shall impose penalties. Preemptive rights of shareholders are not waived by the public offering of shares.

9. Shares

Capital of the SA is represented in shares. A shareholder shall not be liable for obligations incurred by the corporation and shall only be liable for the unpaid price of shares he individually suscribed (art. 163 LS).

Law No. 24.587 and Executive Decree No. 259/96 required that all private securities and provisional certificates issued in Argentina shall be nominative and non endorsable. "Non-Scriptural" (no certificates are to be

issued) shares shall continue to be admitted under the new law. Consequently, all transfers of securities shall be registered, and the issuer shall be notified of that transfer. Coupons may still be issued to bearer.

All bearer shares issued in countries other than Argentina shall have to be deposited in a bank and the rights attached to it shall be exercised by the showing of a certificate issued by that bank (the certificate is also nominative non-endorsable).

Present bearer shares are converted by operation of the law and their certificates shall be presented to the corporation for their conversion into nominative, non-endorsable, or non-scriptural shares within six months. Bearer shares that are not converted shall give no exercise of rights and shall not be transferred or made the object of security rights until converted. Bearer shares authorized for public offering shall only be sold until 22 May 1996, and they shall be deposited with the authorized depositary of shares (Caja de Valores S.A.) to be transacted upon.

Debt certificates (bonds) that have been authorized for public offering, may be transacted upon whenever they are contained in global or partial certificates registered or deposited in Argentina, or in institutions recognized by the Argentine agency for securities and exchange (Comisión Nacional de Valores).

All tax exemptions related to bearer shares are abolished. The legal history of bearer shares in Argentina is varied. Laws 20.643 and 23.299 already adopted the same solution of no-bearer or endorsable shares by immediate conversion of existing ones. Law No. 23.697 (Economic Emergency) reestablished the possibility of issuance of bearer and endorsable shares (conversion was not automatic: it required a specific Shareholders' Meeting Resolution). The law of November 1995 is a new chapter in this history, although by no means a definitive one.

Shares shall all be of the same nominal value and that value shall be expressed in Argentine currency on the face of the instrument or on the provisional certificates (before issuance of share certificates). No par shares (shares with no nominal face value) are allowed. The nominal value of the shares indicates the degree of participation (voting and patrimonial rights) a shareholder has in the corporation. Share certificates shall only be issued upon total payment. No division under the nominal value of a share is allowed (voting rights to one share must be exercised by just one person in case of dissent). Basic information on the corporation shall be indicated on the share certificates, with the exception of capital, which may be under constant variation. The law does not specify sanctions for omission of formalities (art. 211 LS), but nullity is a possible consequence in cases where the information omitted is essential.

10. Classes of Shares
(a) Ordinary shares with voting privileges (art. 216 LS). Ordinary shares normally grant only one vote per share, but a category of ordinary shares may be granted the benefit or more than one vote by the articles of incorporation and bylaws ("multiple vote" or "plural vote" shares). They may grant a right of to up to five votes per ordinary share.

The reason for this is the acknowledgement by the law of the aspirations of a group seeking to control the SA without owning the majority of its equity. This policy is under strong criticism, and no voting privileges may be conferred to shares after a corporation has decided to offer its shares. A voting privilege is incompatible with a patrimonial preference on dividends. During discussion of the most important issues to be considered by the Extraordinary General Meeting of Shareholders, these voting privileges may not be exercised (art. 244, inc. 4 LS). They are not considered for the fulfillment of quorum requirements; quorum depends on capital ownership and not on voting privileges.
(b) Preference shares (art. 217 LS). Preference shares confer a priority in the collection of dividends (patrimonial preferences). They are sometimes issued with the right of the corporation to redeem or repurchase them, and they are normally denied voting rights (that right may be denied to them: art. 217 LS), but they may vote (even when that right has been denied) in the opportunities envisaged by art. 244, inc. 4 LS. (transformation into another type society, extension of the term of the corporation, dissolution before expiration of the term, change of domicile into a foreign country, fundamental change in the purposes of the corporation, reduction of capital, default in paying the preferential rights, suspension of public offering of shares, etc.). Holders of preferred shares may be present at Meetings of Shareholders and have a voice. They shall be able to vote during the time the corporation is in default of payment of the dividends stipulated. If the corporation makes public its shares in an Exchange, they shall vote at all Meetings if the Exchange suspends the offering of the corporation No preference shares shall have a multiple vote privilege (art. 216 LS).

Most common preference clauses are:

(i) an additional participation in earnings;

(ii) a right to a preference in dividends, by (a) an assured percentage of the earnings, or (b) a fixed amount on the nominal value of the preferred share certificates (which can be cumulative); and

(iii) a preference on the proceeds in liquidation of the corporation.

11. All shares shall be nominative non endorsable shares, "Scriptural" (no certificate) shares that are an entry in the corporate books (art. 208 LS).

(a) Provisional certificates. Provisional certificates are also nominative and non-endorsable and contain an indication of the amount of the capital paid-in (art. 211, inc.4 LS).
(b) Global certificates. Global certificates may only be issued by corporations that have been authorized to make public offerings of their shares (art. 208 LS). Their issuance shall occur only after being deposited in an authorized depositary of shares (Caja de Valores, arts. 30 et seq. Law No. 20.643). A purchaser of shares can always require an individual certificate, provided the global certificate had been issued before the time of the purchase.
(c) "Non-scriptural" shares ("acciones escriturales"). "Non-scriptural" shares are not represented in certificates. They are only an entry in the account held in the pertinent register of the corporation, commercial bank, investment bank, or authorized depository of shares (Cajas de Valores) in which they are registered. A statement of the account shall be delivered to the shareholder by the registering institution (art. 208 LS). They are nominative non-endorsable.
(d) Coupons (art. 212, par. 3 LS). Coupons are representative of dividends to be cashed by the shareholder. They are severed from the certificate to enable exercise of the right to obtain payment of dividends.

12. Transfer of Shares

Shares are subject to the sale provisions of the Commercial Code. Whenever the transferor of shares has not paid for his subscriptions, he will be jointly and severally liable for the debt incurred with the transferee. If the transferor indeed makes a payment after the transfer, he will be said to own an interest in the share in proportion to the payment made. Both the transferor and the transferee are liable to the corporation, even if the transfer has been registered in the corporate books.

13. Restrictions on the Transfer of Shares

The rule is that shares of the SA are transferable, meaning that they do not require consent of the rest of the shareholders and/or of the corporate boards or meetings to be transferred to another shareholder or a third party. The articles of incorporation can limit the transfer of shares, but it cannot totally impede, as an outright prohibition would be null and void. Share restrictions are considered to be part of the articles of incorporation and bylaws and as such are stated specifically in the articles themselves or introduced later by a resolution of the Extraordinary General Meeting of Shareholders (art. 235 par. 1, LS). There is opinion that a resolution taken to introduce a restriction engenders the right to recede in the dissenting shareholder. Any and all restrictions shall be stated in the

pertinent share certificate, in the statements of accounts, and in whatever certificates are issued. Restrictions not stated in the pertinent documents cannot be opposed by the third-party buyer (art. 214 in fine, LS).

There is also opinion that there should be a fair price for the transferor. The statute provides a judicial procedure to obtain consent to the transfer of interests for SRLs (in case opposition is not justified), which some consider applicable to the SA (art. 153 LS).

Some believe that given the common usage in Argentina of the close corporation where equity belongs to families, restrictions should be allowed more freely in the "family" SA, provided they are not based solely on the will of majority shareholders or the board of directors. The theory of "abuse of rights" has been used in this context.

Given a restriction in the bylaws it has been required that the transferor and transferee show evidence that the corporate decision not to accept the candidate is based on discriminatory reasons serving the interest of the majority, or that the reasons invoked by the majority are but a veil obscuring a scheme to impose the majority will to the detriment of the minority.

At the same time, restrictions imposed to "maintain the cohesion of the group" and the "supremacy in the administration" have been considered valid, but there is opinion that these arguments are abusive. The most usual restrictions are: (i) consent of the majority of shareholders or of the Board of Directors and (ii) the rights of preemption and accretion.

14. Certificates of Debt ("Obligaciones Negociables")

Laws No. 23.576 (1988) and 23.962 (1991) modified the "convertible bonds" introduced by law in No. 19.060 and thus enabled the issuance of certificates of debts in Argentina. Certificates of debt can be issued only by corporations ("sociedades por acciones"), including cooperatives, civil associations and foreign corporations. In the case of corporations, certificates of debt can be issued by a resolution of the Ordinary General Meeting of Shareholders and does not require amendment of the articles of incorporation or bylaws. The Board can determine the issuance conditions. Certificates of Debt can be issued with secured or unsecured guarantees. Certificates can be converted into shares, if stipulated in the issuance conditions. Certificates of Debt sold on the open market are tax-exempt. The Federal Agency in charge of Securities and Exchange ("Comisión Nacional de Valores") must authorize offerings on the open market. A specific provision in the law permits Certificates of Debt to enter and exit Argentina freely.

PYMES (Medium to Small Enterprises) do not need authorization of the Securities Agency. This method of financing appears successful.

Investors are attracted by the interest, which is higher than bank's interest. Two Rosario, Santa Fe corporations have used this new method of financing, at least one of them successfully. The issues are sold either through brokers or on the open market. Before accepting the issue, brokers make a risk assessment.

I have consulted with a broker in Buenos Aires regarding whether Heavy Duty Argentina II ("Heavy Duty II") will be able to obtain financing. The broker discounted selling shares in the open market because Heavy Duty II is too small. Considering Heavy Duty II's gross sales and financial instability (it has just come out of financial dire straits), the broker estimated that, if his firm found Heavy Duty II has a reliable administration, marketable products, and no debt, $1 million would be the maximum loan. This amount would be too small to issue shares. Nobody would buy the shares, and their expense would be enormous. The broker would, however, consider selling certificates of debt on a flat commission of 1.5% of the issue. The investors would receive a return of approximately 15% yearly. Current expert opinion is that financing Heavy Duty II with certificates of debt is the only alternative to the shareholders in Rosario, Santa Fe, and Argentina providing financing personally. Bank loans would be the most expensive alternative (20-25% yearly). Furthermore, foreign banks do not readily lend money to small Argentine corporations because of the risks involved. Only the top twenty Argentine corporations have credit from foreign sources. Before the crisis of the 1980s, some foreign banks had extended credit to medium enterprises in Argentina. The foreign banks, however, had great trouble collecting their loans. Accordingly, they have not again demonstrated an interest to participate in the market.

There are no legal constraints on investments from abroad in Argentina, the country has no legal constraints for foreign investments. Executive Decree No.1853/93 removed all restrictions concerning foreign investments. This Decree ratified some previous measures. The USA/Argentina Treaty of 1992 assured US investments in Argentina of receiving "most favored nation" status. Banking authorities have not intervened in loans made to subsidiary corporations. Comunicación BCRA "A" 2161 lifted all previous restrictions for such loans.

F. Personal Liability

Having decided that Heavy Duty Argentina II is to be a Sociedad Anónima (corporation) I will examine under this heading the liability of Directors in the SA. Liability of corporate directors is provided for in Ley de Sociedades: arts. 274 et seq.

1. Personal Liability of Directors

Directors have a duty to act with the loyalty and diligence appropriate to a good businessman (art. 59 LS). The violation of that duty is called "bad performance" ("maladministration"). Directors are also personally liable for specific cases of disloyalty or negligence. The general duty of diligence is amplified over that required of the general public director. Such cases overlap each other and with bad performance. The "good businessman" standard is a stricter standard than the ordinary standard of a "good pater familiae." Liability is restricted to cases of gross negligence, abusive conduct, and intent to prejudice with knowledge thereof. Violation of the statute, the articles of incorporation, and the bylaws may also engage a director's personal liability (art. 274 LS).

(a) Maladministration ("bad performance"). Courts have not allowed directors to avoid liability by stating that: (i) they did not have sufficient time to perform their duties; (ii) they did not have the knowledge required for their performance; or (iii) they did not act at all in their office. A Director may be liable as a member of a collegiate board. The Director's conduct is judged according to the board's activities, whether or not the director has acted personally in the specific circumstances and regardless of the functions the Director was in fact performing. Each board member has a responsibility to control the entirety of the business operation. This responsibility gives rise to liability for "culpa in vigilando" (a duty to control). Examples of violations resulting in Director liability include: (i) selling land at below market prices; (ii) taking loans at above market interests; and (iii) setting excessive personal salaries.

(b) Violation of the statute, the articles of incorporation, and the bylaws. This is an all-inclusive category. All acts of maladministration, gross negligence, and abusive conduct as well as intentional acts fall in this category. The primary definition of an "illicit act" is an act against the law in violation of proper conduct. Illicit acts give rise to compensation. Given the "good businessman" standard formulated by the law, all acts of maladministration, etc., violate that standard, and consequently, violate the law.

(c) Any prejudicial acts performed with knowledge thereof, abusive conduct, or gross negligence. Gross negligence implies intent. Examples of abusive conduct include: (i) exceeding the functions specifically set forth in the articles of incorporation or bylaws; (ii) violating the plural representation established by the articles of incorporation and bylaws or corporate resolutions (such as issuing an IOU); and (iii) acting outside the corporate purpose (such as dedicating a business corporation entirely to be a holding corporation).

2. Limits to Liability of Directors

(a) Division of functions. A director's liability will be restricted where specific tasks have been assigned to one or more directors. Assignment can be established by: (i) the articles of incorporation and bylaws; or (ii) a resolution of the General Meeting of Shareholders. Such a resolution must filed with the Registry of Commerce in order to be valid. Corporate presidents may not use their position as corporate legal representatives to limit their own liability. "Compulsorily collegiate" acts are also problematic. "Compulsorily collegiate" acts, such as the approval of financial statements, encompass the entirety of the business operation. The specific protest requirement also hinders liability restrictions.

(b) Protest and information. A director who has either participated in the discussion and/or resolution adopted at a Board Meeting, or obtained such knowledge later, may evade liability. To do so, the director must file a written dissent (objection) in the corporate books and inform the Syndic. An abstention or other conduct, such as requesting consultations, is not sufficient to evade liability. The written objection must be filed before the director's liability has been actually demanded by the corporate bodies, the controlling agencies, or court petition. Any protest must be in relation to specific discussion or resolutions. A general dissent regarding the Board's performance is not sufficient to avoid liability. This duty to protest and inform restricts the effectiveness of the division of functions, because it requires the director to file his dissent upon notice of a specific operation. Division of functions does not exempt directors from the need to file dissents if they are cognizant of an operation in a Board Meeting or otherwise. Division of functions, in that context appears restricted to "day to day" operations needing no Board approval. The Syndic, upon being informed, has a duty to investigate and act accordingly (arts. 294, 265 & 251 LS). For resolutions adopted by the General Meeting of Shareholders, the directors must promote annulment of that resolution to evade liability.

(c) Shareholder ratification (by specific approval of the Administration). A resolution passed by the Ordinary Shareholders Meeting contemplating specific: (i) approval of the administration, (ii) renunciation, or (iii) compromise, shall exonerate a director's liability. This also applies to management. Approval of financial statements does not imply approval of the administration.

This ratification shall not be allowed in cases where liability arises from (i) violations of the statute, the articles of incorporation, and bylaws, or (ii) five percent of the capital declaring its dissent. Ratification is not opposable to an administrator in bankruptcy.

The requirement that the ratification not involve illegal acts can render ratification sterile, considering the duty of diligence, otherwise known as

that of a "good businessman," imposed by the statute. All maladministration acts are to be considered against the statute. The vast majority of director liability cases involve such acts.

3. Different Actions for Engaging Liability of Directors

There is diverse legal opinion whether actions against directors are based on contract law, on tort law, or on both. In either case, actions are fault based. Directors are not subject to strict liability.

The above distinction is not entirely sterile because: (i) the statute of limitations for contract actions is from three to ten years, whereas for tort actions it is commonly two years; and (ii) tort liability includes compensation for all reasonably foreseeable consequences; whereas contract liability includes compensation only for consequences derived necessarily from the default.

It must be distinguished between:

(1) *Corporate* action for liability against directors. This action is conferred on a corporation for prejudice done to that corporation. The purpose of this action is to compensate the corporation for the acts or omissions of its director. The amount of damages established in return for loss or injury shall be cashed by the corporation. It is called a "social" action (corporate action). The corporate action may be brought where:

(a) the corporation prejudiced against the director. This action requires a previous resolution of the Ordinary General Meeting of Creditors. Access to judicial procedures is denied without evidence of having demanded first the appropriate corporate resolution. The resolution to proceedings shall imply the immediate removal of the director involved, who shall then be replaced. This action is based on contract law. Consequently, the contract of society statute of limitations is applied (three years). Some legal opinions base this action on tort and consequently apply the tort statute of limitations (two years). Other rare legal opinions base this action on contract for services, where the statute of limitations period is ten years.

(b) by the shareholders (derivative actions). This is called a "uti singuli social action." It may be brought against the corporation and the director by:

(i) those shareholders constituting the minimum five percent that opposed the General Meeting of Shareholders' resolution that in fact approved the administration of the directors. It also may be brought when that five percent negative vote did not occur, if the alleged liability is derived from an alleged violation of the law or of the articles of incorporation and bylaws. This is a vast category. Any shareholder may bring an action under any circumstances, provided

the shareholder requested previously a corporate resolution on the matter.

(ii) by any shareholder whenever the General Meeting of Shareholders has already passed a resolution to bring proceedings to obtain compensation for a director's fault, provided those proceedings have not been installed by the corporation within three months of the resolution having been passed; and

(c) by the bankruptcy administrator in a bankruptcy proceeding who may also become a party in an action installed before bankruptcy. If the administrator in bankruptcy fails to promote those proceedings, then any creditor may promote them before the bankruptcy judge three months after requiring the administrator to promote the action. The proceeds obtained shall be handed over to the administrator but the triumphant creditor shall obtain a priority lien on the assets recovered; and

(2) *Individual* liability actions (direct suits). This is clearly an action based in tort installed by a prejudiced party against an offending director (with a statute of limitations period of two years). Legal opinion does not find a contractual basis for this action. The consequences of the offense lie in the estate of the third party and whatever compensation is granted shall be recovered by it directly. It is conferred upon both the shareholders and any prejudiced third party who is not a shareholder. There are no corporate interests involved in this action. No previous corporate action is required in this case. Even when ordered to compensate, the director is not removed from office.

4. Prejudice and Causation: Problems Derived From Their Requirement

This action requires evidence of specific injury caused by the director. Evidence of misadministration, abuse of functions and/or violations of either the law or the articles of incorporation and bylaws is not enough. No eventual damages are admissible. Generalizations shall not be considered. Sufficient causation of the injury suffered, whether by the corporation, the shareholder, or a third party, and the damaging act have to be demonstrated. This distinguishes the action for liability from an action for removal, where injury is not relevant. The sufficient causation requirement is a major block for the proliferation of director liability suits.

(a) Reasons why liability actions against directors are rarely promoted. Cases involving liability of directors are rare. They do exist, however, principally in the city of Buenos Aires. I will try to figure out why.

1) Proof of damages is difficult. This difficulty is enhanced when accounting records are deficient. A system of presumptions might be useful.

2) The recent 1995 repeal of the disqualification procedures in bankruptcy may add a further difficulty to obtaining liability.
3) In practice, most directors are also guarantors of loans. Thus, it is easier for creditors to obtain liability out of the collateral than through a liability action invoking misadministration.
4) There is widespread lack of interest by the penal judges in Santa Fe in investigating economic crimes, especially due to the lack of specialization of the courts. In Buenos Aires there are special tribunals for economic crimes which usually carries through to the civil courts.
5) Extension of bankruptcy proceedings. Argentine bankruptcy law (No.19.551 (1972)) has adopted the French practice of consolidation in bankruptcy. This is an application of the American doctrine of disregard of legal entity. The consolidation procedure has been applied widely. Basically, the procedure consolidates bankruptcy by extension where the corporate entity has been abused by intermingling of assets or by shadow owners unduly using the corporate assets to their own benefit. Judges quite readily use the various legal devices. If abusive conduct can be shown, it may be easier to promote an extension of bankruptcy proceeding than a liability for misadministration action.

5. "D & O" Insurance

Currently, there is no insurance policy authorized for directors' misadministration in Argentina's insurance industry. There may be no need for it. Given the law required to establish liability (misconduct, acts in bad faith in knowledge thereof, gross negligence or dishonesty, or violation of the articles of incorporation and bylaws and/or the applicable statutes) and the local practices indicated above, very few cases of director's liability are recorded. A policy would be possible. However, there have been no applications to the Federal Agency in charge of insurance (the National Superintendent for Insurance) to authorize a director's misadministration policy. Only two malpractice policies have been authorized: for medical doctors and architects and engineers (none for lawyers). The cost of medical policies differs according to the activity involved. A general practitioner doctor will have to pay 4/1000 of the amount insured. In contrast, a high-risk doctor, such as an anesthetist, will have to pay 15/1000. The highest amount insured is $200,000 (U.S. dollars). There are some legal problems with the decision not to insure for a higher amount. As indicated above, there is some discussion on the legal framework in the relationship between a lawyer, a medical doctor, and/or an architect and their clients or patients. In most cases, all three

professionals are liable both under contract and tort law. The statute of limitations period for tort-based claims is two years under Argentine law. The period in contract-based actions, can go up to ten years. Insurance companies are rather wary of issuing policies for such long periods of coverage.

6. Penal Responsibility of Directors

Some provisions in the Argentine Penal Code govern the situation of offenses committed in the course of administration of legal persons.

Directors, managers, administrators, or liquidators of corporations, cooperatives or any other legal person, who knowingly perform, give assistance, or consent to acts that are against the law or the articles of incorporation or bylaws shall be sentenced from six months to two years. If the act performed involves the issuing of shares or interests in capital, the maximum penalty shall be three years (art. 301, Penal Code).

Tampering with the rise or fall of merchandise or public or private securities prices, by means of false news, fake negotiations, or the assembly or reunion of the main holders of a merchandise or gender, with the object of sale or non-sale but at a determined price, shall amount to a sentence of prison from six months to two years (art. 300, Penal Code).

The founder, director, administrator, liquidator, or syndic of a corporation or cooperative, or another legal person, who knowingly publishes, certifies, or authorizes inventory sheets, balance sheets, or pertinent reports, that are false or incomplete, or informs the Meeting of Shareholders or Members, with falsity, reticence, on important facts to appreciate the economic situation of the enterprise, regardless of motive, shall be sentenced to prison from six months to two years (art. 300, Penal Code).

People who by operation of the law, by order of an authority, or by an act of will, are in charge of the management, administration, or care of assets or pecuniary interests belonging to third parties, and who, with the purpose of obtaining for themselves or a third party an undue profit or to cause prejudice, violate their duties, cause prejudice to the interests put into their care or undertake an obligation that is abusive to their owner, shall be sentenced to prison from one month to six years (Art. 173 par. 7, Penal Code).

7. Fraudulent Bankruptcy (physical persons)

(a) Merchants. Merchants adjudged bankrupt that have incurred any of the following conducts (art. 176, Penal Code) will be held liable for fraudulent bankruptcy:

1) simulation of debts, transfers, expenses or losses;

2) inability to justify the transfer or existence of assets that should be of their property, the substraction, or concealment of any asset that should be part of the estate of the bankruptcy; and

3) assignment of an undue preference to any creditor.

Fraudulent bankruptcy carries a prison sentence from two to six years and a special disqualification from three to ten years.

(b) Non-merchants.

Art. 179: Non-merchant debtors under bankruptcy proceedings who, with the purpose to defraud his creditors, has committed or commits one of the acts described in art. 176, shall be sentenced to prison from one to four years.

Non-merchant debtors under bankruptcy proceedings who, during the proceedings of a legal suit, or after an order has been passed, with malice destroys, renders useless, prejudices, conceals, or fraudulently transfers assets from his estate or fraudulently diminishes their value, and in such manner frustrates, in whole or in part, the fulfillment of the pertinent civil obligations, shall be sentenced to prison from one to four years.

(c) Tortious bankruptcy (physical persons) (only for merchants).

Tortious bankruptcy occurs when merchants caused their own bankruptcy and caused prejudice to their creditors, owing to their excessive expenses with relation to their capital and the number of members of their family, ruinous speculations, gambling, the abandonment of their business or any other act of obvious negligence or recklessness (art. 177, Penal Code). A merchant bankrupt held liable for tortious bankruptcy shall be sentenced to prison from one month to one year and a special disqualification from two to five years.

(d) Fraudulent and tortious bankruptcies (administrators).

In cases of bankruptcies of a commercial society, or of a merchant legal person, or when a liquidation procedure has been opened outside bankruptcy of a bank or other financial institution, every director, syndic, administrator, member of the auditing commission, or manager of the company or enterprise under bankruptcy proceedings or from the bank or financial institution in liquidation proceedings outside bankruptcy, or accountant or book keeper of the same, that has cooperated to the performance of any of the cases referred to in the previous articles, shall be sentenced with the penalty of fraudulent or tortious bankrupts, whichever appropriate. The same penalty shall be imposed upon the member of the council, or directive, syndic, member of the auditing committee or the surveillance committee, or the manager, when the case is for a cooperative or a mutuality (art.178, Penal Code).

(e) Connivance between a creditor and a bankrupt debtor.

Art. 180. A creditor who consents in a concordat or agreement in court proceedings, having as cause a connivance between the debtor or a third party, stipulating advantages in exchange for the acceptance of the concordat or agreement, shall be sentenced with a prison term from one month to one year. A debtor, director, manager or administrator of a corporation or cooperative, or of a legal person of another kind, that has been adjudged bankrupt or in a status of liquidation by the court, that makes such agreement, shall receive the same penalty.

(f) Tax evasion crimes.

The Argentine Tax Penal Law (Law No. 23.771) sanctions various crimes, including:

(i) A fraudulent evader is sanctioned with prison from one month to three years. Fraudulent evasion occurs when a responsible debtor uses a double set of accounts, or through false or devious balance sheets, accounting books, or by the failure to issue invoices or valuations made in excess or defect, or by the use of any other fraudulent or devious means conceals, alters, simulates, or does not reveal the real economic or patrimonial situation, with the purpose of obstructing or impeding the assessment of tax or their collection, whenever the act may derive in prejudice to the State (Art. 1).

(ii) The preparer of false tax statements is sanctioned with prison from two to six years. The crime is defined as the making of false or devious statements under oath, incorrect balance sheets or accounting records, labor rolls and/or pay rolls that are not consistent with the actual personnel or that are apt to conceal the actual amount of salaries paid, or any fraudulent means to evade in total or in part the payment of contributions due to the agencies in charge of social security, provided the obligations exceed a certain sum (Art. 3).

(iii) Unlawful retention of taxes by agents in charge of retaining or collecting of taxes or contributions, who have not paid in taxes or social security contributions retained or collected (Art. 7) is sanctioned with prison from two to six years.